Case Study

Risk Management: Pricing, Insurance, Guarantees

Guarantees for Rural Financing
A Guide to USAID's New Mechanism

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This case study was made possible by support provided in part by the US Agency for International Development (USAID) Agreement No. LAG-A-00-96-90016-00 through Broadening Access and Strengthening Input Market Systems Collaborative Research Support Program (BASIS-CRSP) and the World Council of Credit Unions, Inc. (WOCCU).

Introduction – Background on Rural Financing

Access to credit in rural sectors of developing countries is critically low. A majority of the financial institutions in these areas are conservative, relying on heavy asset and collateral–based requirements to induce them to invest locally. They are reticent to lend to potentially risky smaller enterprises and especially to sectors where they have little or no lending experience.

As a result, the growth of financial markets in rural areas has been slow, challenged also by the cyclical nature of business, volatility of weather conditions, and perceived lack of investment options. In the absence of viable local opportunities, many of these countries are net exporters of capital, to avoid currency devaluation. The portion of private capital that remains in-country is predominantly held “under the mattress” or in banks that only lend to large customers with significant assets as collateral. Cash deposits with these banks are often put into government securities to avoid market volatility and the risk of currency devaluation. These investments decrease the liquidity in the banking community and therefore diminish funds available for lending.

The Challenge – Limited Access to Capital

In the rural sector, a significant amount of the credit available for lending has been supplied and subsidized by donor programs and donor-created funds. But increasingly, these funds are competing with local private financial intermediaries which cannot afford to offer the same rates. Understandably, the resulting imbalance has unfairly skewed the growth of these local financial institutions and is contrary to the principles of sustainable development.

Although the demand for financing is strong, the rural sector remains underserved. When funding is made available, the typical commercial bank has collateral requirements of 100-200 percent of the value of the loan, a cost far too high for most borrowers. Creditworthy private farmers and small agribusinesses have difficulty meeting such conditions and often lack the long-term operational or repayment track records they should have to establish their credibility as borrowers. Consequently, financial institutions continue to prefer established lending activity and business relationships, while small rural businesses have very limited, if any, access to financing for critical improvements to their operations.

Financial institutions have little motivation to reduce the requirements for securing such a loan; therefore, educating local financial markets is crucial to lowering their sensitivity to risk. Unless lending institutions are provided the training and technical assistance to find bankable loans in the rural sector, only established areas and business entities will receive financing. Donor capital will continue to be the principle source of that credit until local capital can be mobilized for local investment at market rates. Since development credit will always be limited, the supply of funds will always fall short of demand.

The Solution – USAID’s Partial Loan Guarantee Mechanism

Since 1992, the U.S. Agency for International Development (USAID’s) partial loan guarantee program has worked to connect small and medium enterprises to the local private commercial banking sector to increase the accessibility of financing available to rural markets. When the guarantees are coupled with training and technical assistance, financial institutions can learn to analyze business plans and determine the level of risk in a new loan. The guarantee is offered to direct these bankers to underdeveloped sectors, like rural financial markets, by demonstrating the potential pool of creditworthy borrowers.

The Development Credit Authority (DCA)

In April of 1999, USAID implemented a new credit-financing mechanism to address the need for financial resources to rural sectors. This tool is called the Development Credit Authority (DCA). DCA is based on the premise that there are large reserves of dormant private capital in less-developed countries. It was developed to provide USAID Missions and staff with an innovative way to stimulate lending of resources held in the private sector in addition to, or instead of, traditional grant-funded programs. Whether direct or indirect, DCA guarantees are always financially supported by Missions strategic objectives. The guarantees are directed toward regional areas or market sectors targeted by Missions for economic development assistance. As such, DCA mobilizes private capital, which supports the Agency's global economic growth development strategies.

Since its inception, the DCA mechanism has provided over 50 guarantees, channeling resources to micro-enterprises, small and medium-scale businesses, farmers, mortgage markets and certain infrastructure sectors such as water and energy. The guarantees are typically implemented at the Mission level, in countries where USAID has a Mission or is providing humanitarian aid or relief ("USAID-presence countries"). A guarantee covers up to 50 percent of a lender's net loss on the guaranteed portion of the loan. The loans that are extended under a guarantee should only be provided to qualified, credit-worthy borrowers on commercial terms in local currency and/or U.S. Dollars. DCA guarantees are flexible and can be tailored to meet the needs of a specific financial partner or project.

Unique Characteristics of the Development Credit Authority:

- It covers up to 50 percent of private sector loans, providing a true risk-sharing element that encourages local institutions to take an active role in funding projects in new or underdeveloped areas.
- It is provided to secure debt denominated in local currency, so exchange risk is eliminated.
- It is generally complemented by technical assistance to both lenders and borrowers.

DCA's effectiveness depends on the quality of alliances established between Missions and financial institutions, banks and borrowers, and especially on the level of risk-sharing and active participation. Traditional grant-funding eliminates lender risk by providing 100 percent of the financing and therefore creates a potential for decreased participation in the on-lending of funds by financial institutions. DCA goes beyond the institutions that are heavily weighted in donor-funded programs to support the local financial institutions that have been operating despite the advantage of such shareholder backing.

The combination of technical assistance and DCA partial guarantees is a particularly powerful development tool that puts banks in a position to actively develop new lending opportunities. This assistance provides **significant positive externalities**:

- ☆ It serves to better integrate the private sector with their borrowing community without providing any direct funding for the loans.
- ☆ It reduces the perceived risk and therefore the sensitivity to lend and the reluctance to enter unknown markets.
- ☆ It induces financial institutions to use their own capital for projects through a market-based public-private partnership.
- ☆ It provides the lender with a stake in their own success by maintaining their capital at risk for at least half of the total requested amount of the loans.
- ☆ It enhances economic growth for participating businesses by generating new lines of business for the institution and expanding operations.

Where DCA Guarantees are Offered - Countries and Sectors

In USAID-presence countries, DCA partial loan guarantees focus on the Agency's stated objectives for economic growth. To encourage lending in rural areas, the DCA mechanism can be applied as appropriate to a specific project or set of projects through four different credit guarantees: loan guarantees, loan portfolio guarantees, portable loan guarantees and bond guarantees. The use of DCA is a Mission-lead activity. Each guarantee is designed, developed and managed by USAID's Missions with support from the Office of Development Credit (ODC) in Washington, DC.

In most USAID-presence countries, it is possible to find an intermediary financial institution that can extend DCA-backed loans to agribusinesses, including micro, small and medium enterprises, as well as to the water, energy, environment and infrastructure sectors.

Implementation - Technical Direction

When a Mission determines that one of their projects would benefit from a DCA guarantee, they draft a concept paper and send it to USAID's Office of Development Credit (ODC) for consideration and feedback (see "10-Step Guide to Preparing a Development Credit Authority (DCA) Project", prepared by the Office of Development Credit, March 2003). The Mission works through the ODC's Regional Manager to develop the project and select the appropriate guarantee. Meanwhile, the Mission contacts the lender to obtain select information for the proposal from the lender. With some support and guidance from the ODC and their contractors, the Mission puts a draft development analysis together with an economic and financial viability study of the guarantee request.

This information is gathered to form an Action Package, which the Mission Director signs before submitting it to the Office of Development Credit for review and approval. During the review, all the documents are analyzed to assess the feasibility of guaranteeing the project and determining the level of risk. Once the risk assessment is done, the Agency's Credit Review Board (CRB) meets to evaluate the objective and overall financial soundness of the proposal. When the CRB's inquiry is complete, the Mission works with the ODC and the bank or banks to transfer the fees due to USAID to establish the guarantee. As of the completion of all fund transfers, the guarantee is in effect and loans can be made with the backing of the full faith and credit of the U.S. Government.

Throughout the life of the loan, the bank is required to provide periodical updates to the Mission on the utilization and repayments of the loans made under the guarantee. The Mission maintains its position as the point of contact and visits the lenders and select borrowers on a bi-annual basis.

Preconditions for Financial Institutions to Qualify for a Guarantee

To qualify for a guarantee, Missions are required to conduct brief project feasibility analyses of the developmental, financial, economic, technical and environmental components of the proposed activity. Information gathering varies depending on the credit needs of the lender, but required bank documents typically include: the most recent 3-5 years of audited financial statements, business/strategic planning documents, curriculum vitea of key personnel, financial projections, human resources information, policies/procedures, organization charts, and articles of incorporation.

The Office of Development Credit (ODC) staff conducts a risk assessment based on these inputs as well as information regarding the country, the borrower and transaction structure. USAID also analyzes most borrowers' capacity to repay the loan and may request reasonable assurance of liquidity. These independent analyses determine the viability of the proposed project. They help the ODC calculate the quantity of funds to set aside, called the "loan loss reserve" or the "subsidy cost", to cover the possible outflow of U.S. Government funds from the guarantee, as required by the Government.

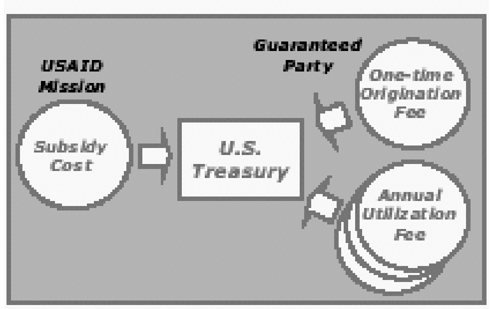
These risk-sharing financial institutions should have a proven track record as an established market participant with sound credit administration practices, adequate management, sufficient capital levels, and high asset quality. In order to benefit from a DCA guarantee, the lending institution should be able to demonstrate a capacity to adequately assess credit risk and monitor its loan portfolio.

Costs to Financial Institutions for Receiving a Guarantee

There are two fees paid by the bank or "guaranteed party" associated with establishing a loan guarantee; the ***origination fee***, a one-time charge to put the guarantee in place, typically between .5% and 2.0% of the maximum loan amount, and a ***utilization fee*** charged semi-annually on the guaranteed portion of the total maximum loan amount outstanding, also for approximately .5% to 2.0%.

Separately, the Mission pays a fee to the U.S. Government, called the ***subsidy cost,*** considered a loan loss reserve, as described earlier, for its role as partial guarantor. It is a risk-based fee calculated by performing a risk assessment on the proposed guarantee and represents the amount of money that USAID will set aside in the USAID account at the U.S. Treasury Department. The cost represents the estimated potential loss from having a guarantee in place, minus the fees paid by the guaranteed party. The USAID account is also funded by the fees from the guaranteed party (see diagram below). It is used to pay any claims that are made by the guaranteed party for defaulted loans under the DCA agreement. During negotiations with the guaranteed party on the terms of their agreement, the Mission sets the percentage rate charged for the origination and utilization fees.

The diagram below demonstrates the two sources of funding for the "loan loss reserve" account.



Transfers to the U.S. Treasury

Sustainability of Rural Financing

USAID and a selected private local financial institution share the risk for the loans under guarantee. Due to the true risk-sharing relationship between them, DCA guarantee activities are expected to be financially sound. USAID's private partners, who agree to share equal or greater risk, are motivated to perform thorough independent risk analyses and provide appropriate project management and oversight for more effective operational oversight of the guarantee, especially in conjunction with Mission and ODC monitoring responsibilities.

A Mission's objectives on economic growth are derived from broader goals set by USAID's development strategies. Those Mission objectives are implemented through grant-funded and guaranteed activities set up by Mission offices and teams. The terms of a guarantee agreement cite the activities for which lending is guaranteed, thereby moving the financial institution into new sectors. Local partners agree to lend directly to specific region or sector where financial markets are under-developed and where the flow of capital is crucial to the survival of businesses.

Extent to Which Program Increases Leverage of Government Funds

The use of DCA guarantees leverages US Government funds in two ways:

1) For a minimal cost to the Mission, DCA offers a significant financial impact to local markets by enabling a much larger amount of funds to be made available to micro, small and medium businesses. More specifically, for every dollar a Mission devotes to a DCA guarantee financial institutions can offer an average of $35 in private-sector loans. At present, the overall cost to USAID for DCA backed-loans of $346 million (or local currency equivalent) is $9.8 million (2.8 percent). Leveraging local capital this way maximizes USAID resources by extending the impact of the Mission's budget.

2) DCA leverages the experience and resources of its risk-sharing partners, since the financial institutions' funds are equally, or more at risk. As a result, the DCA partner performs all the appropriate due diligence on loan requests and the ensuing monitoring efforts, while USAID maintains an advisory role.

How Advanced are Local Capital Markets Where DCA Bond Guarantees are in Place?
Thos same USAID presence countries tend to have very limited local financial markets and primarily consist of short-term bank loans. However, countries with relative depth in their capital

markets can make use of the DCA bond guarantee. Bonds are used on a broad scale to mobilize capital from individuals and institutions. These bonds provide liquidity to a bank in support of the bank's small lending window, as for municipalities developing water piping and clean water systems in rural areas. DCA-backed bonds have so far been used to finance infrastructure projects in India and the Philippines. Structured financing, particularly in the water or infrastructure sector, is also possible in countries with relatively sophisticated financial markets.

Role of USAID's Technical Assistance – source and funding
The access to financing is complemented by USAID advisory and technical activities, including DCA workshops and bank training topics in cash-flow analysis, advanced risk management, risk assessment, and monitoring techniques. Since most banks in developing countries lack the capacity and willingness to lend into certain creditworthy sectors, USAID technical assistance seeks to train these banks to understand new market segments and target borrowers. The goal is to enable banks to overcome traditional reliance on excessively collateralized loans and other market imperfections that impede lending into creditworthy sectors.

This training and technical assistance strengthens the long-term potential of lending to the rural sector even after their DCA guarantee expires. When risk is prudently managed, default rates are minimized and new loans can be underwritten, demonstrating the profitability of expanded lending practices.

Closing of a Loan under Guarantee

Six months prior to the final date of coverage on a DCA guarantee, the Mission will notify the financial institution of the facility's upcoming expiration. The notification will include the date of termination and reference the termination requirements listed in the standard terms and conditions of the guarantee agreement. If a loan is still outstanding the day after the final date of the guarantee agreement, it is no longer covered by the guarantee.

The Mission will monitor the collection of final reports and fee payments, and will work with the ODC on follow-up, processing and the final utilization-fee payment.

Cost Recovery - How Losses are Shared
In coordination with the Office of Development Credit (ODC), the Mission will send out annual notifications to all current and former lenders that have submitted a claim payment. This notification will remind each financial institution that following claim payment they are legally obligated to share with USAID any recoveries received on loans, even those that have been written-off.

Subject to the terms of the guarantee agreement on the percentage of risk-sharing, default claims submitted to the Mission and approved for payment, will be paid by USAID to the guaranteed party upon receipt by the ODC. The Mission will process claims in accordance with guarantee agreement standards, which typically permit the financial institution to submit claims up to six months after the expiration of the DCA guarantee. However, any loan default and subsequent demand by the lender for full repayment from the borrower must have occurred prior to the expiration of the guarantee facility. The Mission will work with the lenders to establish a method for repayment on the portion of all claim recoveries to be shared.

Types of DCA Guarantees

Below are a few examples of how different DCA guarantees are stimulating the growth of lending by rural financial institutions to micro, small and medium enterprises, agribusinesses and farmers.

Loan Guarantee – Mexico

Unión Progreso is a regulated and supervised rural credit union that was established by a small group of farmers in Delicias, Chihuahua. This guarantee provides financing to micro and small agribusinesses operating in rural communities throughout that region. The DCA guarantee will cover a private commercial bank's loan to Unión Progreso, allowing the credit union to reduce its borrowing costs, raise needed capital to expand its lending activities, and offer longer-term financial products to its clients.

Portable Guarantee – Ecuador

Portable Guarantees are appropriate for specific credit enhancement purposes where the purpose and borrower are known, but the lender is not yet known. A portable guarantee provides the borrower, in this case Banco Solidario, with a letter of guarantee commitment through which they shop around the local financial market to obtain the most advantageous terms. Portable loan guarantees are harder to analyze in terms of risk due to the portable nature of the guarantee since the borrowers are not selected until after the guarantee is in place. In these cases, a minimum credit rating (e.g., from rating agencies such as Standard & Poor's and Moody's) is established.

Ecuador's recent financial crises have eroded the country's entire financial system, including second tier sources of financing. The collapse of their markets created a major need to identify and build new local sources of capital to respond to the critical demand for financial resources. As part of a broad strategy to reduce poverty, the Mission recently launched a major microfinance program to increase economic opportunities for the large number of rural poor affected by these events. The DCA facility expands the volume and terms of credit available to the guarantee party, local private bank, Banco Solidario, and supports the institution in its on-going efforts to diversify its lending opportunities. The portable component of the DCA guarantee provides Banco Solidario with a letter of guarantee commitment that they can use to seek the most advantageous terms from their local financial market.

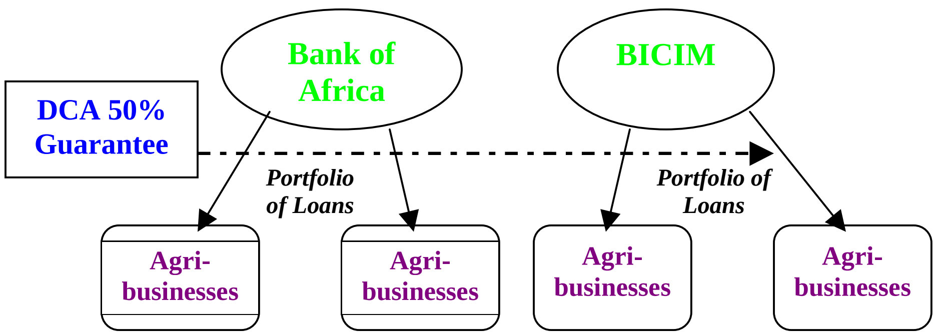
The use of this portable DCA guarantee helps the Mission's three-part program to 1) focus on strengthening microfinance institutions that are committed to sustainability and growth, 2) to improve the policies, regulations and supervisory practices affecting microfinance institutions and 3) to provide financial support to microfinance institutions through both debt and equity instruments.

Loan Portfolio Guarantee – Mali

In September 2001, a DCA loan portfolio guarantee was put in place to encourage the growth of rural lending activities in Mali. USAID signed two different guarantees with private sector commercial banks based in Bamako, Mali: Bank of Africa (BoA) and Banque Internationale pour le Commerce et l'Industrie au Mali (BICIM). The guarantees were aimed at expanding medium-term financing opportunities for agribusinesses to support fixed asset investment lending.

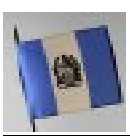
As a response to the Banks' reluctance to approve loans to unknown agribusinesses for medium terms, i.e. four to five years, USAID modified the guarantees in late 2002 to include short-term working capital loans. This will allow agribusinesses to build a credit history with either BoA or BICIM to encourage a longer-term loan by the midpoint of the guarantee in 2005.

The Mission viewed these DCA guarantees as a means to provide access to financing for investments by viable agribusiness clients. Since the late 1990s, technical assistance from Chemonics International, through its Agro-Enterprise Center (AEC), has assisted numerous agribusinesses in the development of their business plans. AEC identifies fixed asset investment opportunities and the capacity of these enterprises to repay the external financing required for the debt portion of the investment. While much progress has been made in strengthening private sector business capacities through the efforts of the AEC, poor access to financing severely hampers adoption of new technical and business practices offered by the AEC to its agribusiness clients. As a result, many firms in targeted sub-sectors have been unable to exploit fully their potential and take advantage of investment opportunities in the sector.



Examples of Rural Financing by Region

Since 2000, DCA partial loan guarantees have proved to be very useful in supporting the development of agricultural projects in USAID-assisted countries. Guarantees are working in countries such as Guatemala, Ethiopia, Ukraine, and Uganda and provide other USAID Missions with examples of how access to private capital can enhance development activities in rural areas. What follows are some illustrative examples of how partial loan guarantees are currently being used to leverage private sector capital to complement on-going and proposed Mission activities in rural areas and the agricultural sector:



Guatemala - Bancafé **-** Loan Portfolio Guarantee – Latin American Countries

Approval date:	Sept. 7, 1999
Start date:	March 1, 2000
Close date:	Sept. 7, 2009
Term:	5 years to place loans; 10 years to submit claims

Amount of loans disbursed:	$3.9 million
Amount of loans outstanding:	$2.7 million
Maximum Aggregate Disbursement:	$5 million
Sector:	Small and Medium Enterprises
Portfolio Quality:	Excellent—0% default

To promote rural lending, USAID has provided a $5 million loan portfolio guarantee to Bancafé, an established Guatemalan bank with a strong rural presence. The bank has made a strategic decision to grow its micro-loan business, and the bank president views the loan portfolio guarantee as the right tool to support this new initiative. The guarantee supports the Mission's strategic objective to increase rural household income and food security, with special emphasis on small farmers and micro-entrepreneurs. It also supports their objective to improve the management of urban growth in targeted areas, in particular the expanded and equitable delivery of urban services in selected market towns.

Poverty in Guatemala is pervasive and severe: the poor, predominantly women and indigenous populations, suffer from limited education, low incomes and unreliable food sources. They have limited access to commercial credit and other support services for agricultural production and family-owned businesses. The lack of adequate economic opportunity contributes to widespread malnutrition.

To remedy this situation, private and public sector investments are needed in and around market towns to provide farmers with expanded opportunities for processing and selling their products. Market towns also serve as centers for micro-enterprise growth.

Borrowers in Guatemala may be prone to default or vulnerable to non-payment, especially in the long term. One of the primary determinants of the project's chances of success is therefore Bancafé's ability to conduct appropriate credit analyses and to adequately monitor the loan portfolio.
Based on the review of a representative sample of files and documents, Bancafé's credit and collection policies and procedures were deemed to be sound. Cash flow projections provided by Bancafé show that the internal rate of return for the DCA loan portfolio is expected to be 26 percent. An additional risk-mitigating factor is the extensive banking experience of their senior management team.

Ukraine - Nadra Bank - Loan Portfolio Guarantee – Europe & East Asia

Approval date:	May 21, 2002
Start date:	Sept. 27, 2002
Close date:	Sept. 27, 2007
Term:	5 years
Amount of loans disbursed:	just completed first reporting period, results pending
Max Aggregate Disbursements:	$6 million
Sector:	Small and Medium Enterprises

Nadra Bank, a privately owned Ukrainian bank, has a partial loan portfolio guarantee to extend loans to small farmers and suppliers. The DCA guarantee will significantly contribute to achieving the intermediate results associated with the Missions' strategic objectives to accelerate growth of private enterprises and develop a more competitive and market-responsive private financial sector.

The Government of Ukraine (GOU) and USAID have started to work on a major initiative to issue 1.8 million land titles, and thereby create the same amount of new landowners. It is predicted that at least 20-30 percent of them would have a strong desire to farm their own land. Therefore, it is critical to ensure that these newly landed farmers have a reasonable chance of succeeding. One of the biggest obstacles facing the entire agricultural community in Ukraine is the lack of access to credit for purchasing equipment and inputs. Small-scale farmers have an even more difficult time than the large-scale farms, many of whom still have access to capital inputs from their investors who bought the majority positions in these farms at the time of the reorganization process. In order to break out of this cycle, the GOU is looking for ways to offer small-scale farmers a source of credit at reasonable rates and terms that will enable them to purchase new assets.

If the private farmers can access financial resources, crop inputs, and cash markets as well as technical know how, they stand a good chance of succeeding. With no effective strategy in place to provide seed money to empower newly landed private farmers, they will fail in greater numbers and there is a real danger that many of them will decide to lease or sell their land to powerful former farm managers and other oligarchs. Without a source of credit, the small private farmers will not be able to prosper and the land privatization process will flounder.

The DCA guarantee, in conjunction with the Rural Credit Project will provide technical assistance to promote bank lending to small farmers and suppliers, whose primary customers are private farmers by: (1) providing loan portfolio guarantees that will help mitigate the perceived high risks of commercial lending; (2) overcoming legal and regulatory obstacles, such as excessive loan loss provisioning requirements, prohibitive collateral requirements, and collateral eligibility problems; and (3) building the participating bank's experience and capacity for lending to small farmers and plot holders.

> Considerable progress has been achieved in the agriculture sector in the past six years. Regrettably this progress has not translated into a major improvement in the financial health and general performance of the sector. Nor, more importantly, has it led to the significant increase in the size of the sector and its capacity to deliver credit and other products in the amounts that Ukraine's agriculture sector needs.

Mobilizing bank lending to small farmers and plot holders will generate substantial economic benefits. Access to credit will facilitate enterprise development and preparation for the WTO and global market integration, thus promoting private sector led output, export and employment growth in Ukraine. Growth in competitive sectors also will generate substantial up and down-stream benefits in terms of demand and employment throughout the economy. In addition, increasingly widespread financial intermediation will improve corporate controls and the business climate.

The Mission aims to address the obstacles to private sector growth with a comprehensive set of coordinated measures that supplement this guarantee in the agriculture sector that comprise policy advocacy, technical assistance to farmers, agricultural marketing and credit mobilization.

Uganda - Barclays Bank of Uganda Ltd. - Loan Portfolio Guarantee - Africa

Approval date:	Aug. 29, 2001
Start date:	Feb. 4, 2002
Close date:	Feb. 4, 2007
Term:	5 years
Amount of loans disbursed:	$1.1 million
Amount of loans outstanding:	$1.1 million
Max Aggregate Disbursement:	$5.5 million
Sector:	Micro and Small Enterprises
Portfolio Quality:	Excellent—0% default

USAID/Uganda proposed the use of the Development Credit Authority in order to introduce a multi-bank loan portfolio guarantee into Uganda that would provide desperately needed access to finance for microfinance institutions (MFIs) and micro, small, and medium enterprises (MSMEs). The activity contributes to the achievement of the Mission's strategic objective to expand sustainable economic opportunities for rural sector growth and represents an integration of environment, agricultural development, and economic growth portfolios. This guarantee also contributes to their objective to increase rural household incomes.

Traditionally, most Ugandan banks and other providers of credit have focused on large multinational companies as their target customers. SME and agricultural business loan facilities have not been readily offered by lenders because of high delivery cost and poor past experience in these sectors. Lenders have had to rely almost exclusively on the value of collateral to support the loans, as they have not been provided adequate financial information to use proper cash flow analysis techniques in the loan appraisal process. Most SME and agricultural applicants cannot qualify because they lack acceptable security, and those few that do receive credit are often burdened with unreasonable repayment terms due to improperly structured loan facilities.

A November 2000 USAID-financed assessment of SME and agricultural lending conditions in Uganda indicated willingness on the part of bankers to expand their SME and agricultural portfolios but under condition that the risks be reasonable.

Implementation of the DCA activity will improve the development affect of USAID to foster economic growth in the rural areas of Uganda, and will assist the GOU in its efforts to ameliorate the country's business environment. DCA loan portfolio guarantees provide an excellent implementation phase support to complement ongoing programs to strengthen the MSME and agriculture sectors. These guarantees, used effectively by the selected seven local commercial banks, will provide the coverage to make necessary investments to stimulate the growth of MSMEs. The result of this effort will be sustained economic growth in rural Uganda and an increasingly knowledgeable financial banking sector. Without expanding sustainable economic opportunities for rural sector growth, the goals of many USAID/Uganda programs, including those in other sectors that touch on rural sector growth peripherally, may not be met.

Challenges of Implementing a DCA Guarantee
There are three general challenges that the Office of Credit Development faces in increasing the availability of this new facility to USAID Missions and staff.

Knowledge and Understanding - The first is to communicate the existence of DCA and relay its usefulness to each Mission. There are Missions who are not aware of DCA and its ability to expand the impact of their budget on the strategic objectives for their region. There are still many areas within Missions where this facility could be used to compliment their activities for economic growth. DCA is either unknown to them or especially those who want to leverage their budgetary costs by using the facility.

Outreach, training and education are used and consistently needed to build the level of knowledge about DCA as a credit assistance option. The knowledge base Missions have is growing but is in some cases mis-understood as a concept and a tool. There is a definite complexity of implementation for DCA as compared to grant-making, which further training and education will continue to address.

Implementation – The second is the level of coordination and participation from Missions and banks during the development stages of a DCA guarantee, including the level of technical assistance, especially after the initial project is funded.

Banks are resistant to lend in underdeveloped sectors because of the aforementioned lack of experience with the agricultural sector, reliance on heavy collateral rather than anticipated revenue stream and the difficulty in processing foreclosures. Unresolved issues related to land titling can complicate the picture because of legal limitations on the repossession of assets and collateral used to secure a loan. This is another reason that a DCA guarantee can play an integral role in the need for financial institutions to manage their portfolio risk.

Although there is support and guidance from the Office of Development Credit, as previously mentioned, this facility is powered by USAID Missions staff. They develop, drive, implement and monitor its usage. Over the last year, the Office of Development Credit has become aware that Mission employees who recognize the benefits of DCA guarantees are sharing their knowledge and belief in it with other Missions. When they relocate, those people who have been involved in implementing a DCA or have learned about it from other Missions are promoting it to their new teams and Mission Directors. It is crucial to keep up this momentum so that all the USAID Missions are aware of what this tool can offer and so that they can reach out to the banks and businesses for which this mechanism could make a difference.

Management Capacity: There is a human resources component to the implementation of such a mechanism. Staff within the Missions and partnering financial institutions must have some understanding of accounting practices and financial analysis. There is a need for monitoring, information collection and on-going communication at Mission and local bank levels, but some do not have the financial experience or management track record necessary to engage in proper analysis of suitable projects and loans.

Methods Used to Overcome Challenges to Implementation
The consistency of communications with USAID's Missions is the key to effectively delivering this facility. That activity is done through presentations, publications, trainings, workshops and

of course, during visits to each Mission. The initial use of DCA is its own catalyst for new guarantees to be established. The experience and relationships initiated provide another form of promotion for DCA, as USAID staff move from one Mission to another, sharing the knowledge and benefits of the program. It is a surprising and beneficial side-effect of providing this facility, as well as a strong testament of DCA's value.

Conclusion: Results and Impact - Why DCA is a Success

Demonstrate the financial viability of lending to new areas and development projects, encourage innovation, and address market failures.

Increasingly, private sector activities formerly assisted through grant funding are now being assisted with disciplined, less costly DCA credit enhancements. Since 1999, DCA guarantees have been issued in over 19 countries, mobilizing the local currency equivalent of approximately $346 million in private sector credit financing. Guarantees provide a forum through which banks gain valuable experience financing higher-risk borrowers. Several key positive externalities include lowering financing requirements as a pre-condition of lending, increasing the pool of potentially creditworthy borrowers, and improving the returns of scale to lending institutions by diversifying their portfolios.

As the private sector successfully experiments with the use of DCA loan guarantees, new economic relationships are being forged. These activities add to the financial depth of underdeveloped markets. Technical assistance combined with this type of risk management tool will continue to provide a powerful combination of resources. The expectation is that such efforts will create a level of understanding and comfort so that capital can continue to flow to these sectors when DCA assistance is no longer available.

In summary, long-term economic growth depends on the mobilization of private capital to local projects across the whole spectrum of rural activities and enterprises. Using DCA grant-funded training and technical assistance, both local financial institutions and USAID Missions work together to develop innovative demonstration activities to mitigate market distortions, mobilize local private capital and expand credit services. Through the strategic use of DCA guarantees, USAID accomplishes short-term development objectives more efficiently and effectively, and likewise, serve as a catalyst for long-term expansion of host-country economic horizons.